ComCover Seminar

Considerations of Risk and Insurance in the Public Sector

10 June 2004

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Auditor-General for Australia
CONSIDERATIONS OF RISK AND INSURANCE IN THE PUBLIC SECTOR

Comcover Seminar
*Getting Wired for Risk Management*
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I. INTRODUCTION

Thank you for the invitation to speak at this *Getting Wired* Seminar. Comcover’s commitment to advancing the management of risk and insurance strikes a particular resonance with me given that the ANAO is equally committed to fostering better practice in *Public Sector Governance* – including the management of risk and insurance.

Despite the increasing attention given to risk management in the public sector over the last eight years in particular, it would not be a surprise to find that many public servants are still quite risk averse. This is likely to be because there is a culture of risk avoidance that is constantly reinforced by an apparent zero, or low, tolerance for loss of public moneys on the one hand and inefficiency in their use on the other, by the Parliament, the Government and the general public, exacerbated by a critical media. There is also a question of being pro-active or re-active in this respect. For example, it has been observed that in the private sector, “a common tendency is to think about risk management as a process to help deal with things that go wrong”\(^1\).

It is also likely that much of our approach to risk management continues to be intuitive rather than as a result of a strict application of the risk management standard (4360:1999 Standards Association of Australia). It is easy to talk about a systematic approach to risk, risk identification, risk assessment and risk treatment, let alone prioritisation of risk. The problem is how do we address the various risks confronting our organisations in ways that provide assurance, internally and externally, about our performance and the outcomes (results) we achieve.

The answer to the foregoing question is not simple. We can certainly learn from the experience of others, particularly where they operate in a similar environment, conducting similar operations. However, a significant part of the answer is likely to come from within our own organisations, that is from our own people, as well as from our external stakeholders. That might not be immediately apparent to them. However, both sets of stakeholders would be encouraged by any direct involvement in helping to establish a strategic and operational framework for risk management across the whole organisation with an emphasis on integration at all levels. This approach would facilitate consistency in approach as well as greater understanding of both organisation-wide and specific area risks to minimise not only duplication and overlap of activity but also encourage real commitment and ownership. That is, it is regarded as everyone’s responsibility not someone else’s.

The Australian Government’s long-term policy of virtual self-insurance, or non-insurance, may well have given the impression that risks did not have to be managed but simply avoided. The notion of insurance is also likely to focus people’s attention
on the financial rather than performance dimensions. The attitude might then be that, once suitable insurance is provided, there is no further need to consider the management issue as the problem is taken care of. One lesson that we are learning is that we cannot afford to take a narrow view of risk and its treatment. When it is realised that 70 to 80 per cent of an organisation’s risks are non insurable, this could lead to a perception that such risks have no financial dimension and therefore do not have to be considered further.

Insurable risks are those risks where an organisation can access insurance to mitigate the financial consequences of the risk (for example, theft and damage to property where the asset is replaceable). Non insurable risks are risks where insurance does not offer any mitigation of the risk as the consequences are often non financial (for example, not achieving organisational objectives and actions or advice resulting in a diminished reputation). However, there are financial risks which may not be insurable, either because there is no ‘market’, or they relate to government activities, such as regulation or security arrangements.

Most Commonwealth organisations have been required to take out insurance for insurable risks of a general insurance nature since late 1998 and insure workers’ compensation matters since 1988, through Comcover and Comcare respectively. Comcover’s active promotion of organisation-wide risk management since 1999, has given organisations the opportunity to raise the maturity of risk management to a level at which they can seek to refine existing plans and procedures to better link risk treatments (such as insurance) to the organisations’ risk exposures and priorities.

Against this background, my contribution to the seminar today is largely based on a snapshot of ANAO’s findings and recommendations from Audit Report No. 3 of 2003-2004 on the Management of Risk and Insurance. Given the focus of the seminar and the time available, I will focus mainly on the links between managing risk and insurance within a corporate governance context. I will conclude with some observations on better practice in this area.

II. RISK MANAGEMENT AND ORGANISATIONAL GOVERNANCE

The role of risk management in corporate governance, and specifically, in determining organisational exposures, opportunities and priorities, creates the need for risk to be considered during strategic and business planning activities. Risk management strategies must be fully integrated with the strategic and business planning approaches of entities so that:

- planned business outcomes, outputs and activities do not expose the organisation to unacceptable levels of risk;
- utilisation of resources is consistent with organisational priorities; and
- the risk management strategies are integrated with the management actions of staff at all levels in the organisation, including recognition that all staff have a responsibility to manage risks.
Risk management is the term applied to a logical and systematic method of establishing the risk context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximise opportunities. Risk management is considered to be an integral part of good management practice.

Risk management is also central to an organisation’s control structures and, therefore, its corporate governance. This view is supported by the Australian Stock Exchange, which considers it to be an essential principle of good corporate governance. To ensure that organisational objectives are being met, and priorities are being addressed in the correct order, an organisation-wide view of risks and controls is necessary. In turn, such a view will reflect the culture, or ‘tone’, that has been set for the organisation by its leadership within its governance framework, based on a strong values/ethical commitment.

The priority imperative requires the organisational planning timetable to allow for risk identification and treatment to be contemplated ahead of the traditional strategic and business planning processes. Risk management and business planning should also be linked as business objectives and strategies provide the structure and context for identifying risks and opportunities. Strategic risk management is a means of coordinating, overseeing and modelling the interrelationship of important risk factors across the business or organisation functions. In recent years, we have seen the emergence of the notion of Enterprise Risk Management (ERM) as an holistic approach. In part, it was a response to a sense of inadequacy in using the ‘silo-based’ approach to risk management, including to insurable risk, as has been observed by many commentators. I have also commented on these issues elsewhere.

Figure 1 illustrates the links between corporate governance, risk management and insurance frameworks and their application.
There are a number of reasons that organisations should want to integrate the management of risk and insurance. These reasons are best expressed in terms of the benefits arising from integration. Such benefits include:

- better managing the affordability of insurance, by obtaining insurance that addresses identified gaps in the organisation’s risk profile and where insurance is considered to be a cost effective treatment;
- demonstrating an effective risk management program is in place thereby reducing the insurers perception of the risk attached to a particular organisation and reducing the cost of premiums. This benefit has been demonstrated by Comcare activities and Wollongong City Council’s approach to obtaining general insurance\textsuperscript{10};
- better managing the affordability of other risk control and treatment strategies, by recognising the full set of controls and treatments in place and eliminating elements of duplication;
- ensuring that a comprehensive set of controls and treatment strategies are in place to address financial and non financial consequences of the risk occurring, rather than simply addressing one aspect of the consequences;
- better understanding the likelihood and consequences of insurable risks occurring through information captured as part of the insurance program and feeding this information into the risk assessment and management process;

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**Table: Frameworks Application Reporting, Monitoring and Review**

<table>
<thead>
<tr>
<th>Frameworks</th>
<th>Application</th>
<th>Reporting, Monitoring and Review</th>
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<tbody>
<tr>
<td>Corporate Governance</td>
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<tr>
<td>Risk Management</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Policy Statement</td>
<td>Develop an organisation-wide Risk Management Plan</td>
<td>Reporting to, and monitoring and review by, Senior Managers on the application and outcomes of the framework.</td>
</tr>
<tr>
<td>• Set of Procedures</td>
<td>Apply the risk management policy and procedures at a strategic and operational level by undertaking a risk management process to produce a risk management plan that includes a risk:</td>
<td></td>
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<tr>
<td>Instructions that provide guidance for staff on the steps involved in managing risk, as well as requirements and expectations of senior managers for achieving the objective of the policy statement.</td>
<td>• register; and</td>
<td></td>
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<td></td>
<td>• treatment plan.</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
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</tr>
<tr>
<td>General Insurance Framework</td>
<td>Apply the policy and procedures from the insurance frameworks at a strategic and operational level by:</td>
<td>Reporting to, and monitoring and review by, Senior Managers on the application and outcomes of the framework.</td>
</tr>
<tr>
<td>• Policy Statement</td>
<td>• identifying and quantifying insurable risk</td>
<td></td>
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<tr>
<td>• Set of Procedures</td>
<td>• obtaining and renewing insurance consistent with prioritised level of exposure; and</td>
<td></td>
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<td></td>
<td>• reporting, management and investigation of incidents and claims.</td>
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<tr>
<td>OHS and Workers’ Compensation Framework</td>
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<tr>
<td>• OHS Policy Statement</td>
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<tr>
<td>• Set of Procedures for OHS and Rehabilitation (or Return-to-Work)</td>
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<td>• OHS Agreement</td>
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• better understanding the adequacy of insurance and other controls and treatment strategies in dealing effectively with insurable risk when it occurs and/or preventing it from occurring; and

• demonstrating to Parliament that the senior management in Commonwealth organisations are fulfilling their responsibilities to efficiently, effectively and ethically manage the organisation. Organisations need to develop appropriate performance indicators to assist in measuring and demonstrating performance.

Increasing insurance costs, both here and overseas, has led to organisations having an increased focus on the affordability of insurance. Ideally, this focus should form part of the risk management activities of the organisation and represent an appropriate response to the organisation’s risk profile. However, the maturity of risk management and insurance practices within many Commonwealth organisations has some way to go before insurance decisions appropriately reflect what would be accepted as a ‘well considered approach’ to risk management in the organisation. Two examples that impact directly on governance may reflect this observation.

Reputation risk

A recent edition of the Australasian Risk Management Newsletter noted that reputation risk can be a major risk for all commercial organisations regardless of size, as well as not-for-profit and government bodies\(^{11}\). The article went on to observe that little attention is paid to this risk by management boards except when an incident arises that negatively impacts on an organisation’s reputation. I suspect the same might be said about many government bodies. Nevertheless, if asked, all Chief Executive Officers (CEOs), and boards in particular, and staff in general, would recognise an organisation’s reputation as critical to its governance and credibility with all stakeholders. Therefore, it needs to be driven by every part of the organisation\(^{12}\).

The article makes two other points that are central to this Paper. First, reputation risk should be managed as part of your organisation’s normal risk management process. Second, the risk should be totally integrated with your operational risk processes\(^{13}\). Because of its pervasive nature, reputation risk will have non-insurable and insurable dimensions. There is no better illustration of the need to be pro-active and take preventative measures aimed at eliminating, or at least substantially reducing, the likelihood of such risk eventuating. The damage caused by failure to act, including any incapacity for remediation, could be catastrophic and threaten the very existence of the organisation or, at the least, its governance team as well as those immediately responsible. That said, my aim is to stress the positive aspects of sound risk management, including the treatment of risk, as a means of promoting the credibility and value of an organisation, as well as its performance, which will, in turn, only enhance its reputation and confidence in its governance.

In relation to the latter observation, I should mention the issue of record-keeping which is currently receiving quite a lot of what I would regard as ‘deserved’ attention. Records are necessary for us to function. It has recently been observed that:

*Just as we need insurance, companies of size and substance need a records program to ensure that they are covered if, and when, trouble strikes.\(^{14}\)*
Integral to that imperative, the author also states that:

*Organisations must take a proactive and holistic approach to compliance that ensures the business, technological, and legal challenges of records management are addressed.*\(^{15}\)

Last year the ANAO noted the importance of record-keeping as ‘a key component of any organisation’s corporate governance and critical to its accountability and performance’.\(^{16}\) Not surprisingly, the report also noted the statutory support for accountability within the Commonwealth. Among a number of recommendations for improvement in record-keeping practices, it was suggested that

*The risk assessments should also review record-keeping from an operational perspective so that organisation’s record-keeping priorities do not pose any legislative or business risk to the organisation.*\(^{17}\)

Three obvious risks that need to be considered are reputation, legal and security risks but there are also considerable operational and financial risks involved that have to be addressed, such as business continuity. However, that is a separate topic in itself but for those interested, I would refer you to the discussion of risk management (pages 16 to 25) of the ANAO’s Better Practice Guide on Business Continuity Management.\(^{18}\) As noted earlier, we still have to deal with the questions as to whether the risks are insurable or non-insurable.

**Taking risk onto the balance sheet**

From a governance viewpoint, it is not only necessary to ensure that a sound risk management approach is in place, for, both assurance and performance purposes, but also that the associated costs are managed well. Public servants are quite familiar with the need for cost effectiveness. Nevertheless, how many of us are aware of the overall financial costs of dealing with risk. A recent survey by an insurance broker and risk consultant provides some indicative information\(^ {19}\).

Many Chief Finance Officers (CFOs) covered in the survey indicated that they had been forced to take more risk onto their own balance sheets. This in turn had focussed their attention ‘on the total cost of insurable risk’. The total cost of insurable risk for this exercise is defined as risk transfer costs (insurance premiums), plus risk retention costs (self-insured losses), plus internal and external risk management costs. As an indication of such cost, the sector, Government, Education and Non-Profit, showed a median cost of $19-32 per $1,000 of revenue, the highest of all the industry and sector groups covered in 2003. Corporate governance was one of the top ten risks identified. The survey supported ‘the assertion that CFOs are managing these risks through their balance sheets’\(^ {20}\). What this means, in practice, is that organisations do not have a proper handle on how much risk actually costs them.

Again, while I am not able to assess whether the survey was representative of the Australian Government’s situation, I suspect that the latter comment would apply to many, if not most, Commonwealth organisations. If that is so, it becomes incumbent on governing bodies, including CEOs, to engage in more active management of their balance sheets as well as securing better information and control over the organisation’s risks and their management. I stress that it is not just the cost of
balance sheet items that require risk management attention per se, such as for millions of dollars of information technology hardware and software, but also the consequences of their failure and/or unfilled expectations. ‘High expectations equate with high risk’.21

The CPA Australia publication last year on balance sheet management in the public sector notes that ‘few are considering what impact these decisions or approaches will have on the balance sheet’.22 As well, it was observed that agency management and executives still consider financial management to be an ‘overhead rather than something that is able to add value to service delivery’.23 The same comment was made in relation to risk management, in particular in relation to performance improvement and enhancing organisation reputation.24 In government, balance sheet implications translate into political/budgetary risks rather than risks to shareholders, as in the private sector.

Closely related to this issue of taking risk onto the balance sheet is the question of identifying significant financial reporting risks from an organisation perspective. In my view, this has been well done in a recent book written by two KPMG executives. They list the following questions which I consider are equally applicable to most public sector organisations:

1. What is our tolerance for financial reporting risks? Have we communicated our tolerance to operating and financial management and the internal and external auditors? Does everyone understand and agree? Is “tone at the top” consistent with our risk tolerance?
2. Does our culture encourage open and candid discussion of our financial reporting risks and processes, including expression of concerns by individuals at all levels in the organisation?
3. Do we know what our financial reporting risks are?
4. Have we considered appropriately the incentive/pressures and opportunities for fraud in our company as well as the attitudes/rationalisations of management and employees related to fraud?
5. How does the audit committee define significant financial reporting risk?
6. Do we understand the interrelationships of our financial reporting risks to each other and to other risks facing the company?
7. Do we know who our risk owners are? Do we have controls in place to manage the risks? Do we have processes in place of measuring and monitoring risk?
8. What is the perspective of the person or department overseeing risk?
9. How do our incentive programs affect risk management?
10. Does our understanding of financial reporting risk permeate our organisation and culture?
11. Does each individual understand his or her role and responsibility for managing financial reporting risk?
12. Is financial reporting risk a priority consideration whenever business processes are changed or improved?25
III. UNDERSTANDING AND IMPROVING THE LINKS BETWEEN RISK MANAGEMENT AND INSURANCE

Insurance is one of the risk treatment strategies available to organisations that is still to be fully understood. Organisations should consider a variety of treatment strategies including the most cost effective combination of:

- deciding to avoid, or eliminate, exposure to the risk;
- developing treatments to reduce and control the impacts of any losses that could result from exposure to the risk; and
- transferring the potential loss associated with the risk to a third party, where that is feasible and effective.

Risk transfer occurs when an organisation cannot economically afford to retain the residual risk. The organisation must then select the most cost-effective method of financing the potential consequences of unacceptable risk exposures that cannot be avoided, minimised or eliminated through the application of cost-effective treatments, such as additional internal controls. Insurance has traditionally been one of the primary methods of risk financing26 because of its simplicity and accessibility. Figure 2, following, illustrates the risk management and insurance considerations of both insurance companies and organisations when entering into an insurance contract.

![Figure 2. Converging interests of insurers, insured and self-insured organisations](source: Thomson CPD 2002. Public Liability Handbook – Balancing risk and opportunity. July. p.57)

Insurable risk is any risk that can be covered by an insurance policy. This may include:

- damage to property and persons;
- professional and public liability;
• security threats to personnel; and
• threats to business safety, such as vulnerable cash arrangements, vandalism, theft, and illegal entry[^27].

I reiterate that it is important to understand that losses associated with a risk occurring are not just financial and that organisations need to manage both the financial and non-financial consequences of the risk. Insurance can only offer support on the financial side of the exposure, which is not adequate for managing, and mitigating, all the potential losses associated with a range of organisation risks. Therefore, insurance is only a partial answer to a range of risk management issues.

It is also important to understand that having access to funds to rebuild or replace also does not mean that organisations will be able to rebuild, or replace, instantaneously. It takes time to replace infrastructure and systems. Organisations need to have back-up systems in place to provide continuity of operations while replacement is occurring. While this requirement might seem obvious, it illustrates the need to take a comprehensive management approach to risk treatment which goes beyond insurable risk.

Improved links between risk management and insurance is driven by increasing insurance costs and reductions in available cover, particularly, for public liability risks. Organisations also seek to improve risk management and their corporate governance frameworks and practices, to enhance overall results.

Comcover has indicated to its clients that, when there is sufficient incident and claims history, the Commonwealth will be in a better position to negotiate with individual clients and reinsurers on a reduction in premiums for good risk experience. The opportunity to maintain or reduce the cost of insurance premiums, and/or to be able to access insurance if a risk occurs, is an additional incentive for organisations to have an adequate risk management framework and plan in place. Moreover, it is essential that there be adequate documentation of incidences and related experience as well as sound analysis of actual exposures.

Comcare has developed extensive guidance material, which is available to clients and the general public on the Internet to assist organisations to fulfil their responsibilities in relation to minimising the human and financial costs of workplace injury in Commonwealth Employment[^28]. Comcare has established performance measures including a low premium rate and a declining trend in outstanding scheme liabilities. These are indicators of both occupational health and safety and workers’ compensation performance[^29].

Comcare recommends that organisations regularly monitor injury trends and claim costs to: help inform the development of prevention and injury management strategies; measure the effectiveness of those strategies; and help identify what is driving organisations’ workers’ compensation costs. Comcare has advised organisations that, if injury and claims information is not monitored and appropriately addressed, premium rates would increase (refer to Table 1[^30]).
### Table 1 – Rising Cost of Insurance

#### General Insurance

<table>
<thead>
<tr>
<th>Commonwealth Pressures (Internal)</th>
<th>Market Pressures (External)</th>
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| • provision of poor quality information to insurers, for example, on historical claims experience and insured values leads to difficulty for Comcover and its reinsurers in pricing risk;  
• the end of three year reinsurance agreements for liability insurance; and  
• steadily increasing claims numbers over the last three financial years. | • the continuing hardening insurance market;31  
• insurance industry analysts anticipate that the hard insurance market will continue for two to three years;  
• fewer reinsurers operating in the market place and those remaining in the market seek higher premiums and deductibles;  
• recent terrorist attacks in the United States;  
• collapse of HIH;  
• the public liability and indemnity crisis;  
• overall declining profitability for insurers;  
• rationalisation of the industry;  
• lower investment returns; and  
• new APRA solvency requirements. |

#### Workers’ Compensation Insurance

<table>
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<tr>
<th>Commonwealth Pressures (Internal)</th>
<th>Market Pressures (External)</th>
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</thead>
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| • increase in the average cost of claims32 and in the frequency of claims (Comcare considers an organisation’s previous four years claims experience);  
• poor management of OHS risks and Return-to-Work programs by organisations contribute to the increases in the frequency and average cost of claims;  
• the estimated lifetime cost of claims; and  
• the number of FTEs. | • lower investment returns;  
• superimposed inflation; and  
• new APRA solvency requirements. |


### Drivers to improving links between risk management and general insurance activities

Annual premiums have been increasing significantly since 1999-2000 because of a hardening insurance market and an increase in claims numbers. However, the latter appear to have levelled out in 2002-2003. In that year the estimated total annual premiums increased by about 86 per cent to $120.5 million (see Table 2). The estimated dollar value of claims (gross) appears to have risen by about 79 per cent to $62.9 million between 2001-2002 and 2002-2003. Claims costs have been rising significantly since 1999-2000 as organisations have become increasingly aware of incidents that may be claimed from general insurance. However, the estimated dollar value of claims has also been impacted in those last two years by the Sydney and Canberra bushfires.
The major types of general insurance claims are property and liability claims. The Commonwealth experienced increases in the numbers of general insurance claims from 1999-2000 to 2001-2002 but with an apparent decline in 2002-2003. Comcover in its publication ‘the Federal Risk Manager’, has cited a number of reasons for increasing premiums. Table 1 outlines both Commonwealth specific and general insurance market pressures causing increases in the cost of insurance in 2003-2004.

The total risk exposure of the Commonwealth and individual organisations within the Commonwealth is unknown. Of the Commonwealth organisations that have purchased general insurance from Comcover (refer to Table 2 above for premium costs and claims information), their cover against potential property exposures is in excess of $40 billion. However, the total value of the exposure uninsured is not specified because total risk exposure, including liability exposures, within the Commonwealth is unknown.

Commonwealth organisations purchase workers’ compensation insurance premiums from Comcare (see Table 3 for premium costs and relevant claims information). However, the maximum possible exposure is in excess of the dollar value of total salary and wages of Commonwealth employees, which is approximately $7.9 billion. At 30 June 2002, the estimated outstanding liability for the Commonwealth, excluding the Australian Defence Forces, was in excess of $1.2 billion. Notional assets cover this estimated liability.

### Table 2 – Commonwealth Organisations Premium Costs and Claims Information – General Insurance

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<tr>
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<tbody>
<tr>
<td>Total Premium Collected ($ million)</td>
<td>43.2</td>
<td>64.8</td>
<td>120.5</td>
</tr>
<tr>
<td>Number of claims</td>
<td>1166</td>
<td>2274</td>
<td>2273</td>
</tr>
<tr>
<td>Estimated Dollar Value of Claims (gross) ($ million)</td>
<td>26.9</td>
<td>35.1</td>
<td>62.9</td>
</tr>
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### Table 3 – Commonwealth Organisations Premium Costs and Claims Information – Workers’ Compensation Insurance

<table>
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</thead>
<tbody>
<tr>
<td>Comcare Insured Employees</td>
<td>149 700</td>
<td>153 652</td>
<td>+ 2.6</td>
</tr>
<tr>
<td>Total Salary and Wages of Insured Employees</td>
<td>$7 604 million</td>
<td>$7 973 million</td>
<td>+ 4.9</td>
</tr>
<tr>
<td>Total Premium Collected</td>
<td>$74.3 million</td>
<td>$79.4 million</td>
<td>+ 6.9</td>
</tr>
<tr>
<td>Claim Frequency Rate Per 100 FTE</td>
<td>3.39 per cent</td>
<td>3.19 per cent</td>
<td>- 5.9</td>
</tr>
<tr>
<td>Average Claim Cost</td>
<td>$10 989</td>
<td>$12 746</td>
<td>+ 16</td>
</tr>
</tbody>
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Source: The information presented in this Table is extracted from the 2001-2002 Comcare Annual Report, Appendix 2 - Facts and Figures, Table 18: SRC Act Scheme Profile (excluding licencees), and relates to Commonwealth organisations.
In 2002-2003, workers’ compensation premiums for Commonwealth organisations, that were not licensed self-insurers, rose by 13 per cent. Comcare has foreshadowed that the 2003-2004 premium rates will increase by 27 per cent for these organisations as a result of increased claims duration and frequency.

**ANA0’s Findings on the Links Between Risk Management and Insurance**

The ANAO’s Audit Report No 3 2003-2004, *The Management of Risk and Insurance*, found that organisations covered were only beginning to understand the link between risk management and insurance. The audit examined the risk management and insurance practices of five organisations in detail and a further fifty, referred to as the Commonwealth group, through a survey. Most were subject to the Financial Management and Accountability (FMA) Act. The link was better understood in relation to occupational health and safety (OHS) because of Comcare guidance (although organisations used Comcare guidance rather than their own risk management framework when assessing OHS risk).

The establishment of Comcover encouraged organisations to focus attention on risk management and introduce general insurance activities. However, Commonwealth Authorities and Companies Act bodies had been obtaining general insurance prior to the establishment of Comcover. Comcover offered a general insurance premium discount for those organisations that participated in a risk management benchmarking study in consecutive years. Organisations that maintained or improved their risk management performance between benchmarking cycles received a premium discount of between three and five per cent. The discount sought to establish a link between sound risk management and insurance. I understand that Comcover intends to strengthen this link in the future when there is sufficient incident and claims history. This would be achieved by negotiating with individual clients and re-insurers a reduction in premiums that reflected good ‘risk experience’, especially in the management of insurable risk.

Organisations would be expected to have a degree of reliance on Comcover, given the specialist nature of insurance, particularly where they lacked such expertise. Nevertheless, the extent of reliance on Comcover for advice regarding general insurance suggested that the link between risk management and insurance had not been adequately managed and integrated. This was because organisations had generally not sought to obtain insurance based on their risk profile and tolerance and generally maintained insufficient documentation/information to understand their insurable risks and their level of exposure.

From the 2001-2002 to the 2002-2003 annual general insurance renewal exercises, organisations demonstrated an improvement in the consideration of factors that could vary the cost of general insurance.

A common finding across all organisations was that insurance that had been purchased was not recognised as part of the risk treatment strategy for the related risk in the risk management plan. In most organisations audited, insurance was not recognised at all. Consistent with audit findings, the survey results indicated that more than 75 per cent of organisations, in the Commonwealth group, did not recognise insurance in risk management plans.
**Integrated frameworks and guidance**

The audit found that all organisations audited had developed, or were developing, some policies and/or procedures that could form part of the frameworks for risk management and insurance. The survey indicated that organisations in the Commonwealth group were less advanced than the five audited organisations as:

- 12 per cent of the former organisations reported that they had not developed a risk management framework;
- 76 per cent reported that they had not developed a general insurance framework; and
- 18 per cent reported that they had not developed an OHS and workers’ compensation framework.

The audit found that guidance for the identification of insurable risk and obtaining and renewing insurance was least likely to be developed. It is noteworthy that these are the first points of integration between the risk management and insurance frameworks.

None of the organisations audited considered the OHS and workers’ compensation framework when developing the general insurance framework. This could have assisted the development of the general insurance framework by identifying insurance tasks that needed to be managed, better practices and minimum requirements. It may also have provided some insight into the links between insurance and risks, and the need to balance risk treatment strategies, by developing preventative treatment options and cost effective risk transfer arrangements.

The audit also found that the risk and insurance frameworks of all organisations audited and surveyed were not sufficiently integrated. There was a lack of recognition of the risk management framework in the insurance frameworks. Similarly, insurance tended to only be discussed in the risk management framework as a form of risk treatment (risk transfer). No reference was made to the insurance framework documents or the areas responsible for managing these functions.

The audit observed that organisations could better integrate these frameworks by developing and providing refresher training that highlighted and clearly articulated the links between risk management and insurance.

**Silo versus enterprise wide approach to risk management and insurance**

The audit found that identification and management of risks were often focussed at the silo level rather than the enterprise wide level, resulting in organisations not recognising common risks and treatments and achieving economies of scale in treating risks.

The audit also found that one factor which could assist organisations in overcoming the silo approach is for organisations to improve the link between risk management and business planning and insurance and business planning. This would be best achieved through the risk management framework.
Risk management, general insurance, OHS and workers’ compensation were often represented as ‘silos’ within an organisation, and managed as separate, rather than related, functions. The audit found that, in the organisations audited, any integration of risk management and insurance was most likely to occur through assigning responsibility for central co-ordination of risk management and insurance activities to one officer of the organisation. General insurance practices in smaller organisations audited and surveyed tended to be linked to organisation-wide risk management activities through the officer that performed central co-ordination responsibilities for both activities. As a result, in the smaller organisations audited (compared to medium-sized organisations), general insurance procedures tended to be better developed and communicated.

Other sources of integration observed in organisations audited were through training materials and databases. However, this integration was limited and did not represent a comprehensive integration of risk management and insurance activities of the organisation as the insurance, rather than the risk management, co-ordinators developed the training and databases. The survey results also suggested that some organisations were integrating the insurance and/or risk management frameworks through databases.

Assessing and monitoring performance of general insurance (and risk management) programs

General insurance programs were immature and there was no basis for properly assessing the performance of the general insurance program, as well as a lack of generally accepted performance indicators for risk management that establish a link to insurance (Comcover intends to provide leadership in this area).

Because of the poor integration between risk management, business planning and reporting activities, most organisations audited considered reporting on risk management (in particular, plans) to be an additional administrative burden that did not need to be performed more frequently than bi-annually or annually. This indicates that these organisations have not developed an understanding of the benefits of managing risks to their business on a timely basis. Organisations needed to improve resourcing of enforcement and monitoring of risk management and insurance activities.

IV. CONCLUDING REMARKS

Most organisations have reasonable risk management processes in place. However, organisations generally need to do more to prevent or minimise risks and/or make the most of the opportunities presented. They need to be more proactive in managing risk by understanding risks, controls and treatments that are in place across the organisation, rather than focussing on a ‘silo’ approach. Specifically, in relation to insurance, they need to be in a position to recognise where existing controls or other treatments sufficiently mitigate insurable risks, and where they are insufficient, appropriate controls and treatments should be used to address the insurable risk exposure.

The management of insurance is not simply a financial issue. It is a broader organisational management issue that is addressed by the managing of risk at the
enterprise wide level. As a result, the management of insurance is not just about reducing insurance premiums, it is about finding the most cost-effective solution to the management of costs associated with risk management and risk events occurring. In a private sector context, this has been encapsulated as follows:

*Good risk management is really choice management. What do you want to do? Do you want to avoid the risk, hedge it, or optimise it? The answer depends partly on deciding the degree of risk your company is willing to assume.*

I noted in my introductory remarks that it will largely be our internal and external stakeholders who will assist us to determine both the nature of risks that confront us and our tolerance for risk. Management’s task is to encourage and garner such intelligence.

Borrowing again on the ideas of the two executives quoted above, the following are some rather basic suggestions which could be helpful in establishing a common risk culture across your organisation:

- Use common risk language and concepts.
- Communicate about risk using appropriate channels and technology.
- Develop training programs for risk management.
- Empower managers with defined risk boundaries.
- Identify and train risk experts.
- Align risk management techniques with company culture.
- Develop a knowledge sharing system.
- Include risk management activities in job descriptions.

The following are a number of better practices observed in the management of insurance and insurable risks, particularly in the linking of risk management to insurance, during the course of our audit last year:

- regular monitoring and documentation of incident and claims trends, including claims costs, in order to understand risk exposures;
- the use of key performance indicators (KPIs), including loss ratios, average claims’ costs and number of claims (noting that Comcover intends to provide leadership in this respect to properly assess performance);
- maintenance of adequate records to determine insurance values;
- documenting risk exposures in an organisation-wide risk management plan and business plan to facilitate widespread knowledge and understanding so that the exposures can be assessed and monitored, as well as documenting controls and treatments so that they are well understood. This would include the recognition of insurance as a risk treatment;
- determining the cost of insurance and level of deductibles, based on an organisation’s risk profile, tolerance and incidences, plus claims experience;
- development of an insurance framework which is linked to the organisation’s risk management framework (Comcover is also providing leadership in this area);
— co-locating responsibility for coordination of risk management and insurance activities to one person in a small organisation, or to one area (or group) in a large organisation; and
— providing insurance and risk management training that clearly articulates, and reinforces, the various links between those two areas with reference to the organisation’s management and financial frameworks.

These are also fairly basic requirements but which often encompass quite complex processes and skills which have not been generally available in the public sector. Any such deficiency needs to be addressed as a matter of priority particularly as it is generally accepted that ‘risk management should be embedded in management processes’. This means that virtually everyone in the organisation is a risk manager. It has been suggested that the term ‘risk coordinator’ be used to describe those who help to ensure good risk management is embedded and support managers in identifying and assessing risks, as well as in deciding on appropriate risk treatments. In the case of insurable risk, we need to engage with professionals who understand both risk and insurance and their links. However, it is likely that they do not understand our business. That is our responsibility.

Maybe of some interest is that CPA Australia’s then Public Sector Centre of Excellence, in a Research Report on Risk Management in the Public Sector in 2001, indicated that Auditors-General (71 per cent) and insurers (65 per cent) were major drivers of risk management practices.41 Perhaps in the future we might see at least some lowering, if not reversal, of those percentages. That outcome is more likely when risk management covering both insurable and non-insurable risk is endemic to the management culture of our organisations. In that respect, insurance is not an expedient alternative to good management no matter how relatively cheap it might be. However, it does help us to deal with uncertainty which allows us to focus more clearly on our organisational purpose. Thus there should be a “WIN-WIN” outcome. I hope this is a result of this seminar and others like it.
NOTES AND REFERENCES


2. Insurance is defined as a legal contract that protects people from the financial costs arising from loss of life, loss of health, lawsuits, or property damage/loss. Insurance provides a means for individuals and societies to cope with some of the risks faced in everyday life. Contracts of insurance, called policies, can be purchased from a variety of insurance organisations. Insurance provides individuals and organisations with the ability to replace the risk associated with uncertainty, with known costs of buying insurance. Microsoft® Encarta® Online Encyclopaedia 2003, *Insurance*, [http://encarta.msn.com](http://encarta.msn.com). © 1997-2003 Microsoft Corporation.


5. The Australian Stock Exchange (ASX) Corporate Governance Council has developed a set of guidelines, *Principles of Good Corporate Governance and Best Practice Recommendations*. This document establishes ten essential principles that the ASX believes underlie good corporate governance. Recognising and managing risk is the seventh of the ten essential corporate governance principles.


10. Interview on Channel 9’s Today program, between Rod Oxley (Wollongong City Council), and Tracy Grimshaw and Steve Liebmann (Comperes), 31 May 2002 at 7.13am.


12. Ibid. p.4.

13. Ibid. p.4.


15. Ibid., p.29.


17. Ibid., p.15.


20. Ibid. p.49.


23 Ibid., p.13.

24 Ibid. p.13.


26 Risk financing is a type of risk treatment that is applied after other treatment options have been applied to identified risks. This form of risk treatment seeks to finance the potential financial consequences of risk exposures.


31 The Australian Financial Review in January 2003 quoted premium rate increases of 135 per cent for individual organisations, and the expectation of increases in premiums in the coming financial year of 30-50 per cent.

32 This is influenced by particular types of claims that are considered high cost claims as they take longer to resolve and involve more time off work. For example, stress related claims, strains, back injuries and occupational overuse syndrome claims.

33 Claims values are only for reported claims and are inclusive of member deductible but exclusive of reinsurane and other recoveries.

34 ANAO 2003-2004. Management of Risk and Insurance. Audit Report No 3, Canberra, 27 August. Refer to Appendix 3, Tables B, C and D. These tables indicate that these two categories of claims were the major types of claims made by Commonwealth organisations.

35 Federal Risk Manager, Spring 2002, Comcover’s Fourth Year of Operations – an Overview of 2001-02, Issue No. 11, pp. 7-8, as well as updated advice from Comcover as at 31 May 2004.


37 At 30 June 2002, the Australian Defence Forces themselves had an estimated outstanding liability in excess of $1.8 billion.

38 This amount includes estimated liabilities associated with the Australian Capital Territory Public Service. Notwithstanding the significance of the liability, in an August 2002 comparative study of Australia and New Zealand Occupational Health and Safety and Workers’ Compensation schemes, Comcare was considered to be performing well compared to most other jurisdictions. Refer to Workplace Relations Ministers’ Council, Comparative Performance Monitoring, Fourth Report.


40 Ibid., p.273.